

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

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Chair
Commissioner
Commissioner
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In the Matter of Minnesota Power's Petition for
Approval of Intra-Company Transfer of
Taconite Harbor Electric Generation Station
and Associated Assets from Rainy River
Energy Corporation-Taconite Harbor to
Minnesota Power

ISSUE DATE: June 11, 2002

DOCKET NO. E-015/AI-01-1988

ORDER APPROVING PETITION WITH
MODIFICATIONS

PROCEDURAL HISTORY

On December 28, 2001, Minnesota Power (MP) filed a Petition for approval of an affiliated intra-company asset transfer between MP and its subsidiary Rainy River Energy Corporation - Taconite Harbor (RRTH). The assets include: 1) the Taconite Harbor electric generating station and associated real estate and other associated property necessary for the Taconite Harbor Plant to generate electricity, 2) the step-up transformers that allow the Taconite Harbor Plant to interconnect with the Taconite Harbor Substation, and 3) any contracts RRTH may enter into with third parties for the sale of the output of the Taconite Harbor Plant (collectively Generation Assets). The Generation Assets transfer from RRTH will be accomplished by operation of law through a statutory merger of RRTH into MP, its parent company.

On January 23, 2002, joint comments were filed by the Minnesota Office of Iron Range Resources and Rehabilitation (IRRR), the Minnesota Pollution control Agency (MPCA), and the Minnesota Department of Natural Resources (DNR) in support of Minnesota Power's Petition.

On February 26, and February 27, 2002, MP and the Department of Commerce (DOC), respectively, filed comments in response to a Commission notice seeking legal standards and procedural comments on this docket.

On March 1, 2002, the DOC filed comments recommending approval of MP's petition subject to reporting requirements and to MP adequately addressing issues raised by the DOC.

On March 1, 2002, the Residential and Small Business Utilities Division of the Office of the Attorney General (RUD-OAG) filed its response to the Commission's notice requesting comments and on March 11, 2002 filed its reply comments. The RUD-OAG agreed with MP and the DOC that MP's petition should be approved but recommended that the Commission order that all transactions between the Taconite Harbor Plant and MP be treated as affiliated interest transactions.

On March 11, 2002, MP filed reply comments. On April 4, 2002, MP filed a spreadsheet updating the spreadsheet attached to the March 11, 2002 reply comments.

This matter came before the Commission on April 11, 2002.

FINDINGS AND CONCLUSIONS

I. The Petition

This Petition arises out of LTV's recent bankruptcy and its decision to divest itself of all Minnesota properties.¹ MP's subsidiary, RRTH purchased the Taconite Harbor Plant (the Plant) and other property from the bankruptcy estate of LTV Steel Mining Company on October 30, 2001. As the owner, RRTH would operate the Plant and sell its output to the wholesale market. However, MP believes that a greater benefit may be derived by holding the Generation Assets under MP's direct ownership, rather than through its subsidiary RRTH and has petitioned the Commission to approve the transfer of the Generation Assets from RRTH to MP.

MP stated that such a transfer would allow greater flexibility in the marketing of the assets and would provide a vehicle through which the Plant's output may be available to MP's customers under certain circumstances. While the generation from this Plant would typically be sold into the wholesale market, it would be available to provide emergency energy thus enhancing system reliability at critical times.

Further, to the extent that output of the Plant is not committed to the wholesale market, this power would be available to MP, through its Split Rock Alliance, to serve its native load requirements. Under this circumstance, the Plant's energy would be dispatched to MP if the price is less expensive than the cost of the next available resource. These potential customer benefits may not be available without this transfer.

This transfer of assets would be accomplished through a statutory merger² between MP and its affiliate RRTH. Upon completion of the transactions, and all necessary Federal Energy Regulatory Commission (FERC) approvals, MP would own the Generation Assets.

Ownership by MP would not negatively affect ratepayers. The Generation Assets would be accounted for "below the line" for rate making purposes and would not be included in MP's regulated utility accounts. Retail ratepayers would be completely insulated from the financial risks and effects of the Generation Assets.

¹ RRTH also acquired the right to purchase or assign the right to purchase certain LTV transmission facilities. This matter was addressed in the Commission's May 22, 2002, ORDER APPROVING PETITION WITH MODIFICATIONS, in Docket No. E-015/AI-01-1648.

² Under Minn. Stat. § 302A.621.

II. The Legal Standards

Transactions between public utilities and their affiliates are governed by Minn. Stat § 216B.48 and Minn. Rules, Parts 7825.1900-7825.2300.

Minnesota Statutes § 216B.48, subd. 3 states in part:

...The commission shall approve the contract or arrangement made or entered into ...only if it clearly appears and is established upon investigation that it is reasonable and consistent with the public interest.

A petition for approval must normally include documentation of the cost of providing the goods and services which are the subject of the contract. It must also include a copy of the proposed contract, a list and narrative description of all outstanding contracts between the utility and the affiliate, an explanation of why the contract is in the public interest, a description of any competitive bidding process used in awarding the contract, and an explanation of any decision not to use competitive bidding. Minn. Rules, Part 7825.2200 B.

Utilities are required to maintain detailed records of their transactions with affiliates, including ledgers and documentation showing on a monthly basis all payments made under each contract and the cost to the affiliate of providing the good or service for which each payment was made. Minn. Rules, Part 7825.2300.

Minn. Stat. § 216B.50 provides in part that a utility shall not purchase any “plant as an operating unit or system... for a total consideration in excess of \$100,000” unless the Commission finds “that the proposed action is consistent with the public interest.”

Minnesota Rules parts 7825.1800(B) and 7825.1400, in part, set forth filing requirements for capital structure approval.

III. Position of the Parties

A. MP

1. Applicable Statutes

MP filed its Petition under Minn. Stat § 216B.48 (affiliated interests) rather than under Minn.Stat. § 216B.50 (property transfer) because, it argued, no consideration would pass between the companies in the statutory merger and RRTH is not a public utility.³ However, rather than pursuing its position that Minn. Stat. § 216B.50 does not apply, MP stated that it has supplied the information required under this statute as well as the affiliated interest statute.

2. Public Interest

MP argued that the transfer of the Generation Assets is in the public interest because it will result in the benefits set forth below.

³ Under Minn. Stat. § 216B.02, subd. 4.

Retail customers will be completely insulated from the financial risks of this purchase and MP's retail customers will not be required to pay any amount associated with this investment. MP will hold the assets as "Utility - Non-Regulated" property.⁴ Under this accounting treatment revenues and all expenses will be accounted for "below the line" for ratemaking purposes and will not be included in MP's regulated utility accounts.

MP, for at least six years, will not seek inclusion of any portion of the Generation Assets in rate base thus further insulating retail customers from the costs of the Generation Assets. If in the future MP believes this resource could be used to meet subsequent capacity needs, Commission approval would then be necessary, providing ratepayers additional protections.

There is a potential benefit to MP's retail customers if the Taconite Harbor facilities are under MP ownership in that there will be an opportunity, when the generation is available and cost effective, to consider using it (through the Split Rock alliance) to serve its retail customers. Since the Taconite Harbor Plant will not be held in rate base and ratepayers will not be called upon to reimburse MP for the capacity this will be a significant benefit to customers. When this resource is sold in the market or is not economical for retail customers, ratepayers would have no liability.

Further, MP has a long history of operating and maintenance expertise with respect to electric generating facilities. MP's ownership of the Generation Assets will allow it to bring its expertise to bear efficiently by eliminating any potential duplication in personnel and administration.

3. Valuation of Assets

MP based its determination of the amount of the acquisition cost allocated to the Generation Assets on the residual of the purchase price less amounts allocated to land, fuel inventory and spare parts as well as transmission facilities.⁵ Fair market values were determined and assigned by MP to the land, spare parts and coal inventory that were acquired in the transaction between RRTM and LTV.

Land Valuation:

MP's Land Management Department developed a valuation of the 30,000 acres obtained from LTV using current market trends and resale potential. MP allocated a \$10 million cost for the land. MP argued that the Land Management Department has significant expertise in the valuation of underdeveloped land in Northeastern Minnesota and that this valuation represents their expert opinion of a fair value of the acquired land.

Spare Parts and Coal Inventory:

⁴ Under Account No. 1019 of the Federal Energy Regulatory Commission's (FERC's) Uniform System of Accounts.

⁵ The purchase of the transmission facilities was addressed in the Commission's May 22, 2002, ORDER APPROVING PETITION WITH MODIFICATIONS in Docket No. E-015/AI-01-1648.

MP obtained from LTV Steel the available financial support for the spare parts and coal pile inventory. MP staff compared those details and values to MP's own inventory and coal cost to determine the reasonableness of the inventory accounting. MP concluded that the balance provided by LTV as of the transaction date was fair and reasonable. For that reason MP used that value as the fair value beginning balance.

4. Request for Variance

Minn Rules Part 7825.1400 and 7825.1800 require disclosure of additional information which is pertinent to capital structure filings and for the purpose of investigating the issuance of securities. MP argued that these rules have no direct relevance and no application to ascertaining the reasonableness of the acquisition of the Generation Assets. It argued that the public interest would not be adversely affected and no other applicable law or statute would be violated if this information is not provided.

B. DOC

1. Applicable Statutes

The DOC stated that not only does Minn. Stat. § 216B.48 apply but also Minn. Stat. § 216B.50 and Minn. Rules 7824.1600-.1800 apply. The DOC argued that clearly the price is in excess of \$100,000 in that MP, via RRTH, paid a consideration for the Generation Assets that will be merged into MP. These assets were not free.

2. Public Interest

The DOC recommended that the transfer of the Generation Assets from RRTH to MP at no additional cost is appropriate. It found that the reasons set forth by MP to support the transfer were reasonable. It agreed with MP that the transfer would be appropriate and compatible with the public interest and recommended that the Commission find it in the public interest.

3. Accounting Methods

The DOC found that MP's accounting for "Utility - Non-Regulated" facilities using separate sub-accounts for tracking all related cost of the Generation Assets and insulating ratepayers from these costs is adequate at this time.

4. Other Recommendations

The DOC recommended that the Commission require MP to report in its fuel clause filings whenever it uses power from this plant to serve retail customers, along with justification showing that energy from this plant was the lowest cost resource available.

The Doc also recommended that the Commission require MP to explain how the fair market values assigned by MP to the land, coal inventory and spare parts were determined and how the acquisition costs were assigned to the assets purchased.

C. RUD-OAG

The RUD-OAG stated that it was in agreement with the DOC's position regarding the applicable statutes.

The RUD-OAG also argued that whenever any power was used from this Plant, MP should be required to file a petition for Commission approval under Minn. Stat. § 216B.48. However, the RUD-OAG would not object to the Commission granting a blanket variance for short-term purchases of power from the Plant to be filed in MP's fuel clause filings with a showing that it was the lowest cost supply.

D. Joint Comments of the Minnesota Office of the IRRR, the MPCA and the MDNR

The State Agencies argued that because the acquisition of the assets previously owned by LTV provides significant benefits to the State and helps minimize the damage caused by LTV's bankruptcy it is in the public interest. They urge the Commission to grant MP's petition.

The IRRR supports the control over the Taconite Harbor generating station and transmission assets by MP and its affiliates because it believes that the arrangement will result in additional jobs in the Iron Range region and will help position the former LTV mine site as an attractive economic development site.

The MPCA supports the petition because it has received commitments from MP that it will upgrade certain emission-related improvements at the Taconite Harbor facility to help minimize air pollution.

The MDNR supports the petition because of Cliffs' commitments to handle the closure of the mine site pursuant to a negotiated closure plan which could relieve the state of an expense that could exceed \$70 million.

IV. Commission Action

The Commission is in agreement with the parties that the transfer of the Generation Assets from RRTH to MP at no additional cost is reasonable and consistent with the public interest. For this reason the Commission will approve the transfer. Further, the Commission agrees with the DOC and the RUD-OAG that this transfer is subject to both the Minnesota Affiliated Interest statute and the Restrictions on Property Transfer statute.⁶ The Commission also recognizes that MP has submitted all documentation required and has met the requirements of both statutory sections.

The Commission will require, for informational purposes, that MP file the accounting journal entries recording the generation and transmission assets on MP's books when the transfer is actually completed for verification and confirmation. This filing would not require Commission review unless questions were raised.

⁶ Minn. Stat. § 216B.48 and Minn. Stat. § 216B.50, respectively.

The Commission will also require further substantiation of the value of the land received by MP in this transfer. The Commission recognizes that the unregulated land component is integral in arriving at the value allocated to the Generation assets and for this reason will direct that MP supply, within 90 days of this Order, on a compliance basis, further substantiation of the land values.

Further, the Commission, recognizing that the Generation Assets will be included within the regulated MP but operated as an unregulated facility, will require MP to file operating policies that detail the services and products exchanged between the regulated operations and the unregulated generation. The filing should also address the issue of the purchase of power by the regulated entity from the unregulated generator, including the circumstances under which power would be purchased and the pricing mechanism applied. This compliance filing should be filed within 30 days of this Order. Such a filing will give the Commission the opportunity for effective overview.

The variance requested by MP of Minn Rules Part 7825.1400 and 7825.1800, as they apply to capital structure and securities information, will be granted. The Commission agrees with MP that the capital structure and securities information required to be disclosed under this rule has no direct relevance and no application to ascertaining the reasonableness of the acquisition of the Generation Assets. Further, the Commission agrees that the public interest will not be adversely affected and no other applicable law or statute will be violated if this information is not provided. The variance will be granted.

Finally, the Commission notes that the decision herein does not prevent any party from raising issues regarding the transfer in a subsequent MP rate proceeding.

ORDER

1. The requested transfer of the Taconite Harbor generating assets from RRTH to MP under Minn. Stat. § § 216B.48 and 216B.50, as recommended by the Department of Commerce and set forth in section IIIB herein, is approved with the following modifications:
 - MP shall file, on an informational basis, accounting journal entries recording the generation and transmission assets on MP's books within 90 days of completion of the transfer;
 - MP shall file further substantiation of the land values to be supplied within 90 days on a compliance basis;
 - MP shall file the operating policies/guidelines detailing the services and products exchanged between the regulated operations and unregulated generation. This compliance filing shall be made within 30 days of this Order and shall detail the types of services and products exchanged, and the pricing methods established;

The compliance filing shall also address the purchase of power by the regulated entity from the unregulated generator detailing under what circumstances power would be purchased and the pricing mechanism applied. This filing shall also describe the record retention of evidence supporting the purchase as the lowest cost alternative, and the reporting mechanisms;

- the variance requested by MP to Minn. Rules 7825.1400 and 7825.1800 as they apply to capital structure and securities information is granted;
- the Commission's decision does not preclude the raising of issues regarding the transfer in subsequent MP rate proceedings.

2. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

(S E A L)

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